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Insurance Coverage of Punitive Damages

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I. Introduction

Punitive damages[1] are awarded against a tortfeasor primarily to punish his behavior and deter others from similar conduct.[2] If these goals are to be furthered then the tortfeasor should be foreclosed from escaping personal liability through insurance.[3] Nevertheless, the majority of courts permit coverage when the tortious conduct is otherwise insurable.[4] These holdings are based on liberal construction of the insurance contract[5] and on a belief that punitive damages are not an effective means to punish or deter outrageous conduct.[6] The purpose of this note is to examine the rationales surrounding this insurability question and to suggest the most plausible approach to be followed by the courts.

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1. According to RESTATEMENT (SECOND) OF TORTS § 908 (1979):

(1) Punitive damages are damages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others from similar conduct in the future.

(2) Punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of the defendant's act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant.

2. *Id.* The theory of punitive damages has been criticized as an improper function of tort law, *see, e.g.,* DEFENSE RESEARCH INSTITUTE, THE CASE AGAINST PUNITIVE DAMAGES (1969).

3. *See* notes 52-57 and accompanying text *infra.*

4. The most recent cases are: Price v. Hartford Accident & Indem. Co., 108 Ariz. 485, 502 P.2d 522 (1972); Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, 440 S.W.2d 582 (1969); Abbie Uriguen Olds. Buick, Inc. v. United States Fire Ins. Co., 95 Idaho 501, 511 P.2d 783 (1973); Continental Ins. Co. v. Hancock, 507 S.W.2d 146 (Ky. 1974); First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 389 A.2d 359 (1978); Harrell v. Travelers Indem. Co., 279 Or. 199, 567 P.2d 1013 (1977); Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 383 S.W.2d 1 (1964); Dairyland County Mut. Ins. Co. v. Wallgren, 477 S.W.2d 341 (Tex. Civ. App. 1972); State v. Glens Falls Ins. Co., __ Vt. __, 404 A.2d 101 (1979); Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 267 N.W.2d 595 (1978).

5. *See* notes 19-50 and accompanying text *infra.*

6. *See* notes 58-77 and accompanying text *infra.*

II. Background

A. The Scope of Punitive Damages

Punitive damages may be awarded, over and above compensatory damages, in an amount sufficient to punish the defendant's conduct and to deter others.[7] The types of activities that merit such an award vary. Punitive damages may be awarded when the defendant commits an intentional tort shown to be "aggravated by evil motive, actual malice, deliberate violence, or oppression."[8] A punitive award may also be made when malice is inferred, as in a malicious prosecution case in which the defendant is found to have lacked probable cause for his actions.[9] Other courts have allowed punitive damages for an act of gross recklessness, such as driving while intoxicated, which exhibits a wanton disregard for safety but lacks a specific intent to cause harm.[10] Generally, however, simple negligence, without more, is insufficient to support an award of punitive damages.[11]

B. The Scope of Liability Insurance

As a general rule liability coverage excludes "intentional injuries."[12] This rule may result from an express limitation in the policy,[13] or from public policy considerations.[14] Whether express or implied, however, this exclusion does not limit coverage only to liability resulting from negligent acts. In most insurance policies an intentional injury is defined as one in which, from the insured's standpoint some harm is intended or certain to result.[15] Thus, an assault and battery would fall within the exclusion, while extreme

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7. RESTATEMENT (SECOND) OF TORTS § 908, Comment a (1979).

8. Black v. Sheraton Corp. of America, 47 F.R.D. 263, 271 (D.D.C. 1969).

9. *See, e.g.,* First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 248, 389 A.2d 359, 369 (1978) (Levine, J., dissenting).

10. *See* Harrell v. Ames, 265 Or. 137, 508 P.2d 211 (1973). *Cf.* Ross v. Clark, 35 Ariz. 60, 68, 274 P. 639, 642 (1929) (allowing punitive damages for gross negligence); Focht v. Rabada, 217 Pa. Super. Ct. 35, 368 A.2d 157 (1970) (punitive damages for wilful and wanton conduct). *See also* Crull v. Gleb, 382 S.W.2d 17, 23 (Mo. Ct. App. 1964).

> In order for a plaintiff to recover punitive damages in Missouri, he must prove malice, either actual or legal. In actual malice, the action is motivated by hatred or ill will. Legal malice is the intentional doing of a wrongful act without just cause or excuse in reckless disregard of the rights of others.

Id.

11. Gordon v. Nationwide Mut. Ins. Co., 62 Misc. 2d 689, 309 N.Y.S.2d 420 (Sup. Ct. 1970), *aff'd,* 37 App. Div. 2d 265, 323 N.Y.S.2d 550 (1971).

12. Caspersen v. Webber, 298 Minn. 93, __, 213 N.W.2d 327, 330 (1973).

13. *See, e.g.,* State Farm Fire & Cas. Co. v. Muth, 109 Neb. 248, 207 N.W.2d 364 (1973).

14. If there is no exclusion in the policy, intentional injuries may be covered if coverage would not encourage the conduct or if the insurer may be subrogated against the insured. *Compare* Ambassador Ins. Co. v. Montes, 76 N.J. 477, 484, 388 A.2d 603, 606 (1978) *and* Wolff v. General Cas. Co. of America, 68 N.M. 292, 361 P.2d 330 (1961), *with* New Jersey Mfr's Ins. Co. v. Brower, 161 N.J. Super. 293, 300, 391 A.2d 923, 927 (1978).

15. *See* Crull v. Gleb, 382 S.W.2d 17, 21-22 (Mo. Ct. App. 1964); State Farm Fire & Cas. Co. v. Muth, 190 Neb. 248, __, 207 N.W.2d 364, 366 (1973).

recklessness, exhibiting wanton disregard for safety but no intent to harm, might not.[16] Since punitive damages are not limited to cases in which harm was intended, and one may insure for more than mere negligence, cases arise in which an insured's liability insurance could cover a judgment including punitive damages.[17]

Such claims for coverage for punitive damages arise commonly in automobile negligence cases involving charges of wilful and wanton conduct due to defendant's alleged intoxication.[18] When an insured defendant seeks coverage under those circumstances, the court may be faced with two questions: first, does the insurance contract include coverage for punitive damages; and second, is such coverage against public policy?

III. Contract Interpretation

Courts are split on whether a standard liability policy should be read to include coverage for punitive damages.[19] Courts must usually deal with policies that read substantially as follows:

> The Company will pay on behalf of the insured *all sums* which the insured shall become legally obligated to pay as damages *because of*
>
> A. *bodily injury* or
>
> B. property damage
>
> to which this insurance applies, caused by an occurrence, and arising out of the ownership, maintenance or use . . . of any automobile . . . .[20]

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16. Pennsylvania Thresherman & Farmers Mut. Cas. Ins. Co. v. Thornton, 244 F.2d 823, 827 (4th Cir. 1957).

17. *Id.* In *Thornton* the court stated the following:

> Negligent conduct may be so gross as to permit characterization as willful and wanton in the sense of the rule for punitive damages, yet fall far short of an assault and battery which would distinguish it from an accidental event and withdraw it from the coverage of the policy. Punitive damages are not limited to assaults and batteries, and the award of such damages does not convert the case into an assault and battery.

Id.

18. *See* Annot. 65 A.L.R.3d 656 (1975).

19. Coverage denied: Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934); Gleason v. Fryer, 491 P.2d 85 (Colo. Ct. App. 1971); Brown v. Western Cas. & Sur. Co., 484 P.2d 1252 (Colo. Ct. App. 1971); Caspersen v. Webber, 298 Minn. 93, __, 213 N.W.2d 327, 331 (1973). The number of cases that deny contractual coverage is limited because a number of courts do not reach this question and deny coverage on public policy grounds instead. *See, e.g.,* Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 434 (5th Cir. 1962).

Coverage granted: General Cas. Co. of America v. Woodby, 228 F.2d 452, 457-58 (6th Cir. 1956); Ohio Cas. Ins. Co. v. Welfare Fin. Co., 75 F.2d 58, 59 (8th Cir. 1934), *cert. denied,* 295 U.S. 734 (1934); Norfolk & W. Ry. Co. v. Hartford Accident & Indem. Co., 420 F. Supp. 92 (N.D. Ind. 1976); United States Fidelity & Guar. Co. v. Janich, 3 F.R.D. 16, 19 (S.D. Cal. 1943); Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, __, 440 S.W.2d 582, 584 (1969); Greenwood Cemetery, Inc. v. Travelers Indem. Co., 238 Ga. 313, 232 S.E.2d 910 (1977); Abbie Uriguen Olds. Buick, Inc. v. United States Fidelity Ins. Co., 95 Idaho 501, 511 P.2d 783, 789 (1973); Scott v. Instant Parking, Inc., 105 Ill. App. 2d 133, 245 N.E.2d 124 (1969); Continental Ins. Co. v. Hancock, 507 S.W 2d 146, 152 (Ky. 1974); Harrell v. Travelers Indem. Co., 279 Or. 199, __, 567 P.2d 1013, 1014-15 (1977); Morrell v. Lalonde, 45 R.I. 112, 120 A. 435 (1923), *cert. denied,* 264 U.S. 572 (1923); Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965); State v. Glens Falls Ins. Co., __ Vt. __, 404 A.2d 101 (1979); Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 98, 267 N.W.2d 595, 597-98 (1978).

20. R. KEETON, BASIC TEXT ON INSURANCE LAW 658 (1971) (emphasis added). The

For purposes of determining whether coverage extends to punitive damages, courts focus on the phrases "all sums" and "because of bodily injury."[21]

A. Cases Holding that Liability Policies do not Cover Punitive Damages

Some courts reason that the phrase "because of bodily injury" requires a nexus between the defendant's liability and some physical harm suffered by plaintiff for coverage to exist. Thus, sums paid by the defendant to compensate the injured plaintiff are covered. On the other hand, this nexus is absent in the case of punitive damages, which are awarded to punish a defendant's conduct rather than to make the plaintiff whole.[22] Under this rationale punitive damages are, therefore, found to be impliedly excluded from coverage under the standard liability policy.[23]

This approach seems logical and is supported by commentators,[24] but two difficulties exist. First, such a narrow and conservative reading ignores possible ambiguities in the policy created by the reference to "all sums."[25] Second, and more important, these courts fail to deal with the reasonable expectations of the insured,[26] an issue that has been determinative in other areas of insurance law.[27]

B. Cases Holding that Liability Policies Cover Punitive Damages

The majority of courts construe liability policies to cover awards of punitive damages. While some of these cases may be distinguished because of the policy language,[28] most cases deal with the standard liability clause cited at the beginning of this section. Three rationales are expressed or implicit in the cases that find coverage: first, the policy unambiguously covers punitive damages; second, the policy is ambiguous and should therefore be construed in favor of

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term occurrence as used in this policy means an accident in which the injury was unexpected and unintended. *Id.* at 654. *See also* State v. Glens Falls Ins. Co., __ Vt. __, 404 A. 2d 101, 105 (1979).

21. For simplicity the words "or property damage" will be omitted.

22. *See* note 19 *supra.*

23. *See, e.g.,* Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, 39 P.2d 776 (1934).

24. *See, e.g.,* Anderson, *Indemnity Against Punitive Damages: An Examination of Punitive Damages, Their Purpose, Public Policy, and the Coverage Provisions of the Texas Standard Automobile Liability Insurance Policy,* 27 SW. L.J. 593, 616-19 (1973); Comment, *Insurance for Punitive Damages: A Reevaluation,* 28 HASTINGS L.J. 431, 436-39 (1976).

25. *See* notes 34-40 and accompanying text *infra.*

26. *See* notes 41-50 and accompanying text *infra.*

27. *See, e.g.,* C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 176-79 (Iowa 1975). *See* notes 41-50 and accompanying text *infra.*

28. In Colson v. Lloyds of London, 435 S.W.2d 42 (Mo. Ct. App. 1968), for example, the policy in question insured against "loss by reason of liability *imposed by law* upon the insured by reason of any false arrest. . . ." and there was no reference to bodily injury. *Id.* at 46-47.

the insured; or third, the policy should be liberally construed in accordance with the expectations of the insured.

1. Unambiguous Coverage.—Several courts have focused on the words "all sums" rather than the phrase "because of bodily injury" in order to avoid ambiguity and provide coverage for punitive damages. In *Norfolk & Western Railway Co. v. Hartford Accident & Indemnity Co.,*[29] for example, a United States District Court, quoting policy language defining sums the insured was obligated to pay "because of . . . bodily injury,"[30] stated, "The contract covers '*all* sums which the insured shall become legally obligated to pay.' "[31] From this characterization of the policy the court concluded,

> The policy unambiguously covers "all sums." Punitive damages are a form of damages; when liquidated by judgment, they are a "sum." Thus, this contract does not even present such an ambiguity as would call into play the rule that ambiguities in insurance contracts should be resolved in favor of the insured.[32]

Even if this court correctly included punitive damages within the policy, it clearly ignored the real issue: whether the phrase "because of bodily injury" restricts "all sums" to compensatory damages.[33]

2. Ambiguous Coverage.—Other courts have included punitive damages in liability coverage on the theory that the policy language is ambiguous and therefore should be construed in favor of the insured. The exact nature of the ambiguity relied on, however, is often difficult to discern. In *Carroway v. Johnson,*[34] for example, the Supreme Court of South Carolina stated, "[W]here the words of the policy are ambiguous, or where they are capable of two reasoned interpretations, that construction will be adopted which is most favorable to the insured."[35] The court then held that punitive damages were covered but never defined the ambiguity it relied upon to construe the policy in favor of the insured.

Other courts, focusing on the phrase "because of bodily injury," have indicated the grounds upon which a claim of ambiguity or double meaning could rest. In *Cieslewicz v. Mutual Service Insurance Co.,*[36] the Supreme Court of Wisconsin stated,

> It is the infliction of bodily injury which gives rise to the

29. 420 F. Supp. 92 (N.D. Ind. 1976).
30. *Id.* at 93.
31. *Id.* at 94 n.1.
32. *Id. Accord* Grant v. North River Ins. Co., 453 F. Supp. 1361, 1370 (N.D. Ind. 1978).
33. *See also* General Cas. Co. of America v. Woodby, 238 F.2d 452, 457-58 (6th Cir. 1956); United States Fidelity & Guar. Co. v Janich, 3 F.R.D. 16, 19 (S.D. Cal. 1943); Scott v. Instant Parking, Inc., 105 Ill. App. 2d 133, 245 N.E.2d 124 (1969); Continental Ins. Co. v. Hancock, 507 S.W.2d 146 (Ky. 1974); State v. Glens Falls Ins. Co., __ Vt. __, 404 A.2d 101, 105 (1979).
34. 245 S.C. 200, 139 S.E.2d 908 (1965).
35. *Id.* at __, 139 S.E.2d at 909.
36. 84 Wis. 2d 91, 267 N.W.2d 595 (1978).

cause of action. Once the cause of action arises, punitive or multiple damages are awarded in connection with, or because of, the injuries incurred.[37]

This approach recognizes that there is no cause of action for the conduct of the defendant standing alone;[38] only after some tort is alleged can an action be brought. To plead a tort, plaintiff must allege that he suffered damages, which might include bodily injury. Only when damages, together with the other tort elements, are shown, can plaintiff seek a punitive award. Thus, whenever the plaintiff's damages arise from bodily injury an additional prayer for punitive damages is made "in connection with" or "because of" the bodily injury.[39] At the very least, this approach suggests that the meaning of the phrase "because of bodily injury" is unclear and that the addition of the phrase "all sums" merely serves to further complicate interpretation of the policy.[40]

3. Expectations of the Insured.—Although attention to the details of the policy language becomes mired in semantics, some courts seek to define coverage by asking: What did the insured reasonably expect his coverage to be?[41] This approach recognizes that an insurance policy is an adhesion contract that the insured may not even see until after the "bargain" is struck.[42] Thus, "the insured is justified in assuming that the policy which is delivered to him has been faithfully prepared by the company to provide the protection against the risk he asked for."[43]

Based upon this theory, punitive damages might be considered covered by a "General Liability - Automobile Policy"[44] or similar

37. *Id.* at 97, 267 N.E.2d at 598; *see also* Ohio Cas. Ins. Co. v. Welfare Fin. Co., 75 F.2d 58, 59 (8th Cir. 1934), *cert. denied,* 295 U.S. 734 (1934).

38. *See generally* Comment, *The Relationship of Punitive Damages and Compensatory Damages in Tort Actions,* 75 DICK. L. REV. 585, 591-607 (1971).

39. This argument would be true whether or not the law of the state in question required an actual damage award as a predicate to punitive damages because the argument is based not on an *award* of actual damages, but on the existence of damages upon which a tort may be alleged in the first instance.

40. *Cf.,* Southern Farm Bureau Cas. Ins. Co. v. Daniel, 246 Ark. 849, __, 440 S.W.2d 582, 584 (1969) ("When we consider that under our law, one cannot become legally obligated to pay punitive damages unless actual damages have been sustained and assessed, we find that punitive damages constitute a sum which the insured becomes legally obligated to pay as damages because of bodily injuries sustained . . . .").

41. Professor Keeton suggests this approach to contract interpretation better explains the result reached by many courts purporting to apply an ambiguity test. *See* R. KEETON, *supra* note 20, at 357. Indeed, several cases involving claims of ambiguity also suggest reliance on the purchaser's reasonable expectations. *See, e.g.,* Harrell v. Travelers Indem. Co., 279 Or. 199, 567 P.2d 1013, 1015 (1977); Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 98, 267 N.W.2d 595, 598 (1978).

42. R. KEETON, *supra* note 20, at 350-52.

43. C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 176 (Iowa 1975) (quoting 7 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900, at 33-34 (3d ed. W. Jaeger 1964)).

44. R. KEETON, *supra* note 20, at 653.

insurance. As one court has stated, "A reasonable person in the position of the insured would believe that the language of the policy provides coverage against all civil liability arising out of an occurrence resulting in bodily injury."[45] Punitive damages certainly fall under the heading of civil damages, and, given their broad scope, may be awarded as a result of an occurrence or accident.[46] Thus, the typical insured would expect coverage for punitive damages.[47]

One response to this approach is "that a person has no right to expect the law to allow him to place responsibility for his reckless and wanton acts on someone else."[48] Taken strictly, this argument denies the reckless tortfeasor indemnity for compensatory as well as punitive damages. Assuming, however, only punitive damages are referred to, the answer to this argument rests with the efficacy of such awards. In a legal system that values punitive damages as an important and necessary means to punish and deter, no one could reasonably expect to obtain insurance coverage. Today, however, many courts expressly or impliedly exhibit doubt that civil liability should be used to punish and question whether a punitive award will deter others.[49] Under these circumstances even a person trained in the law might expect coverage for punitive damages and, therefore, an average person would also reasonably expect coverage for these damages.[50]

IV. Public Policy Approach

Several courts have held that even if an insurance contract provides coverage for punitive damages, public policy voids any such coverage.[51] The strength of this policy argument rests not only on an

45. Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 98, 267 N.W.2d 595, 598 (1978). The Supreme Court of Vermont has similarly stated, "[W]e decline to unsettle the insured's reasonable expectation that 'all sums' means 'all sums.' " State v. Glens Falls Ins. Co., __ Vt. __, __, 404 A.2d 101, 105 (1979). *See also* Zuger, *Insurance Coverage of Punitive Damages,* 54 N.D. L. REV. 239 (1976).

46. *See* notes 7-11 and accompanying text *supra.* An occurrence or accident is defined as an event "neither expected nor intended from the standpoint of the insured." R. KEETON, *supra* note 20, at 654.

47. State v. Glens Falls Ins. Co., __ Vt. __, __, 404 A.2d 101, 105 (1979).

48. Nicholson v. American Fire & Cas. Ins. Co., 177 So. 2d 52, 54 (Fla. Dist. Ct. App. 1965).

49. In First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 282 Md. 228, 389 A.2d 359 (1978), the majority opinion exemplifies the belief that punitive damages are ineffective and therefore insurable. As the dissent noted, "[T]he Court has *sub silentio* dealt a death blow to the theory of exemplary damages applied in Maryland for well over a century." *Id.* at 367 (Levine, J., dissenting). *See also* note 64 and accompanying text *infra.*

50. Moreover, to avoid coverage all the insurer need do is insert a clear exclusion of punitive damages. Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 98, 267 N.W.2d 595, 599 (1978); R. KEETON, *supra* note 20, at 352.

51. The public policy and contract issues are not always viewed as mutually exclusive. For example, the reasoning in Universal Indem. Ins. Co. v. Tenery, 96 Colo. 10, __, 39 P.2d 776, 779 (1934), a leading case in the narrow construction of the insurance contract, shows that the court was influenced by public policy considerations.

analysis of the purposes of punitive damages, but also on several competing considerations, most notably the policy of freedom of contract.

A. Rationale that Liability Insurance of Punitive Damages Contravenes Public Policy

The argument that public policy forbids insurance coverage of punitive damages was most effectively advanced by the Court of Appeals for the Fifth Circuit in *Northwestern National Casualty Co. v. McNulty.*[52] McNulty had recovered a verdict for $57,500 against Smith, the insured, for an automobile accident. The damages included a $20,000 punitive award based on findings that Smith had been driving at excessive speeds while intoxicated. McNulty brought an ancillary garnishment action to recover from Smith's liability carrier, and on appeal the company contended that the punitive damage award was not within the scope of coverage.[53]

The court first determined that under the applicable state law punitive damages were intended primarily to punish and deter.[54] After distinguishing several earlier cases in which coverage had been granted,[55] the court concluded,

> The [public] policy considerations in a state where . . . punitive damages are awarded for punishment and deterrence, would seem to require that the damages rest ultimately as well as nominally on the party actually responsible for the wrong. If that person were permitted to shift the burden to an insurance company, punitive damages would serve no useful purpose. Such damages do not compensate the plaintiff for his injury, since compensatory damages already have made the plaintiff whole.[56]

Several other jurisdictions follow this approach.[57]

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52. 307 F.2d 432 (5th Cir. 1962).

53. *Id.* at 433.

54. *Id.* at 434-35. The court applied conflict of laws principles and looked to the law of Florida for guidance. The court found that the primary purposes of punitive damages in Florida were punishment and deterrence, although, a secondary compensatory purpose ssemed to exist. *Id.* at 434.

55. Several cases were distinguishable because the judgments involved lump sum awards in which compensatory and punitory damages could not be separated. *Id.* at 438. Other cases were distinguished because of the compensatory nature of punitive damages under state law. *Id.* at 439. Finally, other cases were found to involve vicarious rather than direct liability. *Id.*

56. *Id.* at 440.

57. American Sur. Co. v. Gold, 375 F.2d 523, 526 (10th Cir. 1966); Grant v. North River Ins. Co., 453 F. Supp. 1361, 1370 (N.D. Ind. 1978); Norfolk & W. Ry. Co. v. Hartford Accident & Indem. Co., 420 F. Supp. 92, 95 (N.D. Ind. 1976); American Ins. Co. v. Saulnier, 242 F. Supp. 257, 261 (D. Conn. 1965); City Products Corp. v. Globe Indem. Co., 88 Cal. App. 3d 31, 151 Cal. Rptr. 494 (1979); Crull v. Gleb, 382 S.W.2d 17, 23 (Mo. Ct. App. 1964); City of Newark v. Hartford Accident & Indem. Co., 134 N.J. Super. 537, 342 A.2d 513 (1975); LoRocco v. N.J. Mfr.'s Indem. Ins. Co., 82 N.J. Super. 323, 197 A.2d 591 (1964); Esmond v. Liscio, 209 Pa. Super. Ct. 200, 212-14, 224 A.2d 793, 799 (1966).

B. *Argument that Public Policy Does Not Forbid Insurance for Punitive Damages*

Few courts challenge the premise of *McNulty* that punitive damages are meant to punish and deter.[58] Beginning with the decision of the Tennessee Supreme Court in *Lazenby v. Universal Underwriters Insurance Co.*,[59] however, the public policy argument has frequently been supplanted by considerations of the general ineffectiveness of punitive damages as a device to punish and deter outrageous conduct and by the possibility of adverse effects on society if insurance is denied.[60] While both *McNulty* and *Lazenby* have already received considerable attention from earlier commentators,[61] two recent decisions[62] provide ground for renewed consideration of the soundness of the public policy argument.

1. Lack of Deterrent Effect.—Lazenby, like *McNulty*, was an action brought against an insurance company seeking payment of an award of punitive damages in an automobile negligence case in which the insured tortfeasor was intoxicated.[63] The court agreed with the enormity of the problem presented by drunken drivers, but went on to conclude the following:

> We, however, are not able to agree the closing of the insurance market, on the payment of punitive damages, to such drivers would necessarily accomplish the result of deterring them in their wrongful conduct. This State, in regard to the proper operation of motor vehicles, has a great many detailed criminal sanctions, which apparently have not deterred this slaughter on our highways and streets. Then to say the closing of the insurance market, in the payment of punitive damages, would act to deter guilty drivers would in our opinion contain some element of speculation.[64]

At first glance this argument seems inconsistent; if the court did not believe that punitive damages serve any purpose, why were they allowed in the first place? Consistency seems to require that once a

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58. Such a challenge would only occur in a state where punitive damages are deemed compensatory. *See, e.g.,* Wise v. Daniel, 221 Mich. 229, 190 N.W. 746 (1922) (Michigan allows punitive damages, but regards them as extra compensation for injured feelings or sense of outrage rather than as punishment).

59. 214 Tenn. 639, 383 S.W.2d 1 (1964).

60. Price v. Hartford Accident & Indem. Co., 108 Ariz. 485, 487, 502 P.2d 522, 524 (1972); Greenwood Cemetery, Inc. v. Travelers Indem. Co., 238 Ga. 313, __, 232 S.E.2d 910, 913-14 (1977); Abbie Uriguen Olds. Buick, Inc. v. United States Fire Ins. Co., 95 Idaho 501, 504-07, 511 P.2d 783, 786-89 (1973); Continental Ins. Co. v. Hancock, 507 S.W.2d 146, 151-52 (Ky. 1974); First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 232-43, 389 A.2d 359, 361-66 (1978); Harrell v. Travelers Indem. Co., 279 Or. 199, __, 567 P.2d 1013, 1016-17 (1977); State v. Glens Falls Ins. Co., __ Vt. __, 404 A.2d 101 (1979).

61. *See, e.g.,* Zuger, *supra* note 45; Anderson, *supra* note 24; Comment, *supra* note 24.

62. First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 389 A.2d 359 (1978); Harrell v. Travelers Indem. Co., 279 Or. 199, 567 P.2d 1013 (1977).

63. Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 641, 383 S.W.2d 1, 2 (1964).

64. *Id.* at 647, 383 S.W.2d at 5. *See also* note 60 *supra.*

court has determined that a species of conduct justifies a punitive award, the effect of that award should not be alleviated through insurance.[65] As the Court of Appeals for the Tenth Circuit stated in criticizing *Lazenby:* "The question is not so much the efficacy of the policy underlying punitive damages; rather it is a question of the implementation of that policy."[66]

The result in *Lazenby* is best explained by comparing the two standards of proof involved. On one hand, courts tend to resolve doubts in favor of allowing punitive awards to be made, and strict proof of deterrent effect is not required.[67] Concurrently, however, courts favor the policy of freedom of contract. Thus, when coverage for punitive damages is found, strict proof is required to void the agreement.[68]

In *Harrell v. Ames,*[69] for example, the Oregon Supreme Court upheld an award of punitive damages for driving while intoxicated, even though there was no clear proof that deterrence would result, stating that,

> It may be debatable whether . . . awards of punitive damages . . . will effectively deter persons from driving after drinking. However, *in the absence of a showing of substantial evidence to the contrary,* we are not prepared to hold that law enforcement officials and courts . . . are wrong in their present apparent assumption that . . . awards of punitive damages may have at least some deterrent effect . . . .[70]

Later, in *Harrell v. Travelers Indemnity Co.*,[71] on the same facts, the court found that insurance coverage for punitive damages was not precluded by public policy. Here the court recognized that a contract freely entered into would be upheld unless it reflected an "evil tendency."[72] Such a tendency was not proved because there was no

> evidence that contracts of insurance to protect against liability for punitive damages have such an "evil tendency" to make reckless conduct "more probable" or that there [was] any "substantial relationship" between the fact of such insurance and such misconduct. Conversely, neither [was] there any such evidence that to invalidate insurance contract provisions to protect against liability for

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65. This is especially true when the jury is instructed to set damages in order to deter. Harrell v. Travelers Indem. Co., 279 Or. 199, __, 567 P.2d 1013, 1030 (1977) (Linde, J., dissenting).

66. American Sur. Co. of N.Y. v. Gold, 373 F.2d 523, 527 (10th Cir. 1966).

67. *See* note 70 and accompanying text *infra.*

68. This state has more than one public policy. Another and countervailing public policy favors freedom of contract, in the absence of overriding reasons for depriving the parties of that freedom. Still another public policy favors the enforcement of insurance contracts according to their terms, where the insurance company accepts the premium and reasonably represents or implies that coverage is provided. Cieslewicz v. Mutual Serv. Cas. Ins. Co., 84 Wis. 2d 91, 103, 267 N.W.2d 595, 601 (1978).

69. 265 Or. 137, 508 P.2d 211 (1973).

70. *Id.* at __, 508 P.2d at 215 (emphasis added).

71. 279 Or. 199, 567 P.2d 1013 (1977).

72. *Id.* at __, 567 P.2d at 1016. The evil tendency test reflects the need to find an overpowering public policy consideration in order to void the contract. *Id.*

punitive damages on grounds of public policy would have any substantial "tendency" to make such conduct "less probable," i.e., that to do so would have any "deterrent effect" whatever on such conduct.[73]

The *Lazenby-Harrell*[74] approach is flawed in at least three respects. First, from a purely pragmatic viewpoint wasteful awards are promoted.[75] Second, the courts did not consider whether the interest in punishing the defendant rather than simply deterring others was sufficient to overcome the insurance contract.[76] Last, the courts' basic lack of confidence in the utility of punitive damages was misdirected. The correct approach would be to abrogate the doctrine of punitive damages rather than to eliminate the utility of punitive damages through insurance.[77]

2. Detrimental Consequences of Denying Coverage.—Two recent decisions have considered the burden of punitive damages too great to be imposed absent insurability.[78] In *Harrell v. Travelers Indemnity Co.* the court found that a per se rule of noninsurability "would include a wide spectrum of conduct that would impose liability not only upon automobile drivers, but also upon business and professional persons, firms and corporations, as well as upon ordinary persons when engaged in a wide variety of activities."[79] To support this, the court gave examples of punitive awards based on conduct ranging from gross negligence to implied malice, and upon statutory treble damages for unlawful trade practices.[80] As the situations cited included normal business risks the court concluded a per se rule of noninsurability would be unsound.[81]

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73. *Id.* at __, 567 P.2d at 1017.

74. *See also* Price v. Hartford Accident & Indem. Co., 108 Ariz. 485, 502 P.2d 522, 524 (1972).

75. *See* note 139 and accompanying text *infra.*

76. The court in *Harrell* probably did not consider the punitory argument because the jury had been instructed to set the damages based on deterrence alone. 279 Or. at __, 567 P.2d at 1022-23 (Holman, J., dissenting). In *Lazenby,* however, the court admitted that the award was meant to punish and deter, but simply failed to consider the strength of the interest in punishment. 214 Tenn. at 646-47, 383 S.W.2d at 4-5. In *McNulty* the court concluded, "[I]t appears to us that there are especially strong public policy reasons for not allowing socially irresponsible automobile drivers to escape the element of personal punishment in punitive damages when they are guilty of reckless slaughter or maiming on the highway." 307 F.2d 441. Thus, at least as applied to automobile injury cases the *Lazenby-Harrell* approach is seriously deficient because it failed to consider whether the interest in punishing the defendant was sufficient to overcome the insurance contract.

77. *See* notes 85-86 and accompanying text *infra.*

78. First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 389 A.2d 359 (1978); Harrell v. Travelers Indem. Co., 279 Or. 199, 567 P.2d 1013 (1977).

79. 279 Or. at __, 567 P.2d at 1018.

80. *Id.* The examples in which Oregon state law allowed punitive damages included gross negligence by a physician, repossession of property by a creditor in utter disregard of the plaintiff's rights, false arrest based on a lack of probable cause, industrial pollution done with intentional disregard of the rights of others, and violations of the Oregon Unlawful Trade Practices Act.

81. Under the [McNulty] rule . . . even though the risks involved in each of these examples were of such a nature as to be encountered in the operation of such business or professions, and the conduct involved did not involve "intentionally inflicted

In illustration, in Maryland punitive damages are always proper in a malicious prosecution action because the requisite malice is an element of the tort itself. Moreover, malice can be inferred from an objective lack of probable cause.[82] Clearly, under this law a defendant could be liable for punitive damages even though his conduct was neither extreme nor outrageous within the meaning of the Restatement of Torts § 908,[83] and despite his subjective good faith.

Understandably, the Court of Appeals of Maryland recently allowed insurance for punitive damages in a malicious prosecution case because

> a small businessman could be crippled or virtually wiped out by an assessment of exemplary damages in a malicious prosecution action where he proceeded with what he regarded as good reason to prosecute a shoplifter but the courts found that he lacked probable cause for such pursuit.[84]

A holding finding insurability solely because of a fear of untoward consequences from uninsured punitive damages is no different from permitting coverage because of a lack of deterrent effect; both rationales fail to explain why the award was permitted initially. One possible explanation is that courts are bound by precedent and only the legislature can attack punitive damages directly.[85] But the usurpation of precedent and legislative function can be no greater when punitive damage awards are neutralized through insurance. If punitive damages are attacked indirectly by the courts in this manner, there is no reason why the judiciary cannot limit them directly.[86]

3. Other Grounds.—Three other grounds for allowing cover-

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injury," any contract with an insurance company to provide protection against the risk of punitive damages as the result of such conduct would become invalid as a matter of "public policy". . . .

Id. at __, 567 P.2d at 1018-19.

82. This explanation of Maryland law is based on Justice Levine's dissent in First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 248, 389 A.2d 359, 369 (1978) (Levine, J., dissenting).

83. *See* note 1 *supra.*

84. First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 241, 389 A.2d 359, 366 (1978). This case did not involve a small businessman but rather a bank that had unsuccessfully initiated a criminal proceeding against a customer. *See also* First Nat'l Bank of St. Mary's v. Todd, 283 Md. 251, 389 A.2d 371 (1978).

In *City Products Corp. v. Globe Indem. Co.,* 88 Cal. App. 3d 31, 151 Cal. Rptr. 494 (1979), the court denied insurance coverage for punitive damages in a malicious prosecution case on public policy grounds. The California court did not consider the effect of this holding on the small businessman even though, as in Maryland, malice would be inferred from the want of probable cause. Thus, under California law if a jury finds that the facts do not show probable cause, a defendant in a malicious prosecution action may be liable for punitive damages despite his subjective good faith.

85. In both *Harrell* and *First Nat'l Bank* the courts suggested that alternatives to punitive damages might be best considered by the legislature. Harrell v. Travelers Indem. Co., 279 Or. 199, __, 567 P.2d 1013, 1021 (1977); First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 237, 389 A.2d 359, 364 (1978).

86. The Oregon Supreme Court has recently allowed a direct limitation on punitive damages absent a legislative enactment. In Chamberlain v. Jim Fisher Motors, Inc., 282 Or. 229, __, 578 P.2d 1225, 1229 (1978), the court held "gross negligence or recklessness is not, in and of itself, sufficient to support an award of punitive damages." Only five years earlier the same

age of punitive damages have been found. First, because punitive damages are discretionary, noninsurability creates the opportunity for unequal treatment; given two equally culpable tortfeasors, one might receive a verdict of compensatory damages that would be covered, while the other might be forced to pay punitive damages out of his own pocket.[87] Although this argument has been criticized for impugning the integrity of the jury system,[88] it is more likely aimed, not at juries, but at the lack of definite standards upon which juries may act in awarding punitive damages.

Second, one commentator has relied on the bounty theory of punitive damages. This theory is based on the reasoning that encouraging private suits through the prospect of a possible punitive award for which the insurer is responsible would relieve some burden from the criminal courts, especially in automobile cases.[89]

Last, courts have suggested that despite insurability, the tortfeasor would nonetheless be punished by higher insurance rates or other penalties for his conduct.[90] No court, however, has claimed any of these other grounds to be controlling on this issue.

At the core of the objections to the *McNulty* public policy rule is dissatisfaction with the law of punitive damages.[91] The court in *McNulty* recognized the arguments against such awards[92] but correctly decided that if precedent allowed punitive damages, then that precedent should not be circumvented by insurance. Any contrary holding not only permits wasteful damage awards, but also substitutes considerations of freedom of contract and "practical effect" for the central issue: are punitive damages necessary? The remaining inquiry in this note is whether the *McNulty* rule admits of any exceptions.

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court held that the wanton or reckless conduct of an intoxicated driver did furnish a basis for punitive damages. Harrell v. Ames, 265 Or. 183, 508 P.2d 211 (1973).

87. Lazenby v. Universal Underwriters Ins. Co., 214 Tenn. 639, 644, 653, 383 S.W.2d 1, 5, 7 (1964) (White, J., concurring). *See also* Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 444 (5th Cir. 1962) (Gerwin, J., concurring).

88. American Sur. Co. v. Gold, 375 F.2d 523, 527 (10th Cir. 1966).

89. Anderson, *supra* note 24, at 628-29.

90. First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 242, 389 A.2d 359, 366 (1978); Cieslewicz v. Mutual Serv. Cas. Ins. Co., 84 Wis. 2d 91, 103, 267 N.W.2d 595, 601 (1978). In addition, the award of punitive damages may often exceed the limits of liability coverage. State v. Glens Falls Ins. Co., __ Vt. __, 404 A.2d 101, 105 (1979).

91. This is particularly clear in Continental Ins. Co. v. Hancock, 507 S.W.2d 146, 151-52 (Ky. 1974), in which the court stated, "[W]e do not deem it against public policy to allow liability . . . to be insured against when the punitive damages are imposed for a grossly negligent act . . . ." The court then added, "Some members of the court feel that punitive damages are an anomaly in the law and would abolish them altogether."

92. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 441 (5th Cir. 1962) ("there is an argument that the law should not favor punitive damages: there is enough of a punitive element in a tort system of liability based on fault").

C. *Cases in Which the Public Policy Theory is Inapplicable*

In several cases courts have recognized that despite the merits of a public policy argument, insurance coverage should be granted for damages awarded as a punishment. These holdings result from the compensatory nature of punitive damages under state law, other statutory policy, the vicarious nature of the liability, and other competing considerations.

1. The Compensatory Nature of Punitive Damages.—Punitive damages are generally recognized to have compensatory aspects,[93] but in some states compensation is the *primary* goal.[94] In Connecticut, for example, punitive damages are limited to the plaintiff's litigation expenses minus taxable costs.[95] When compensation is the goal, obviously public policy is advanced not thwarted, by insurance.

Similarly, if so-called punitive damages serve substantial compensatory and punitive purposes concurrently, courts tend to favor insurability. Thus, lump sum awards in which punitive damages are included, but not distinguished, have been held to be insurable.[96] For example, under the Alabama wrongful death statute all damages are labeled punitive,[97] but since damages may be awarded in cases of simple negligence,[98] it is difficult to argue they do not also serve a substantial compensatory function. Therefore, punitive damages are insurable in Alabama.[99]

2. Statutory Construction.—Due to state regulation of insurance, especially automobile insurance, several courts have confronted the issue of whether a statute expressly or impliedly mandates insurance coverage for punitive damages. In South Carolina coverage for punitive damages is explicitly required,[100] but in most states statutes governing insurance policies, financial responsi-

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93. "[H]istorically, exemplary damages represent nonpecuniary losses such as injured feelings, damaged reputation, humiliation, shame, pain and suffering (in certain states)." Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 441 (5th Cir. 1962).

94. *See* Long, *Punitive Damages: An Unsettled Doctrine,* 25 DRAKE L. REV. 870, 875 (1976).

95. Tedesco v. Maryland Cas. Co., 127 Conn. 533, __, 18 A.2d 357, 359 (1941).

96. *See, e.g.,* Morrell v. LaLonde, 45 R.I. 112, 120 A. 435 (1923).

97. ALA. CODE tit. 6, § 6-5-410 (1975). *See also* Ellis v. Zuck, 546 F.2d 643 (5th Cir. 1977).

98. *See* Employers Ins. Co. of Ala. v. Brock, 233 Ala. 551, __, 172 So. 671, 673 (1937); Birmingham Waterworks Co. v. Brooks, 16 Ala. App. 209, __, 76 So. 515, 518 (1917).

99. In American Fidelity & Cas. Co. v. Werfel, 230 Ala. 552, 162 So. 103 (1935), the court extended the rule that punitive damages under the death act were insurable to a situation in which there was no wrongful death claim. The court reasoned that since the defendant's insurance policy would cover punitive damages awarded under the death act, it would cover other punitive damages. *See also* Capital Motor Lines v. Loring, 238 Ala. 260, 189 So. 897, 899 (1939).

100. S.C. CODE § 46-750.31(4) (Supp. 1975). "The term *'damages'* shall include both actual and punitive damages." *Id.* Section 46-750.32 requires that liability insurance protect, "against loss from liability imposed by law for *damages* arising out of the ownership, maintenance, or use of . . . motor vehicles . . . ." (emphasis added).

bility laws,[101] and uninsured motorist statutes[102] are equivocal. Such statutes are generally construed not to require coverage of punitive damages, and only in Texas,[103] Georgia[104] and Vermont[105] have contrary results been reached.

The language of some insurance laws is very broad, lacking even the "because of bodily injury" qualification found in many liability policies. For example, the "Kansas Automobile Injury Reparations Act"[106] requires insurance for any "loss from the liability imposed by law for damages arising out of the ownership, maintenance or use of any . . . vehicle . . . ."[107] Facially, this provision seems broad enough to cover punitive damages, and, therefore, to be declarative of the public policy of Kansas.

In *American Surety Co. of New York v. Gold*,[108] however, the Tenth Circuit Court of Appeals, interpreting Kansas law on an earlier but similar provision, held that coverage for punitive damages was not required. The court reasoned that because the legislative purpose of the insurance statute was to provide compensation for accident victims, and because punitive damages in Kansas were meant to punish, the Kansas legislature had not intended to require insurance for punitive damages.[109]

A contrary result was reached by a Texas appellate court in *Dairyland County Mutual Insurance Co. v. Wallgren.*[110] This court made three findings of law: first, that a standard liability policy should be read to include coverage for punitive damages;[111] second, that the policy language in question was approved by the state insur-

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101. *See, e.g.*, N.Y. VEH. & TRAF. LAW § 311 (McKinney Supp. 1977).

102. *See, e.g.*, FLA. STAT. ANN. § 627.727 (West 1973).

103. Dairyland County Mut. Ins. Co. v. Wallgren, 477 S.W.2d 341 (Tex. Ct. App. 1972).

104. Greenwood Cemetery, Inc. v. Travelers Indem. Co., 238 Ga. 313, 232 S.E.2d 910 (1977). *See* note 116 *infra.*

105. VT. STAT. ANN. tit. 8, § 4203 (1979), requires an insurance company to "pay and satisfy any judgment that may be recovered against the insured upon any claim covered by the policy to the extent and within the limits of liability assumed thereby." In State v. Glens Falls Ins. Co., __ Vt. __, 404 A.2d 101 (1979), the court found that a standard liability policy covered punitive damages. Based on the above statute, therefore, the court found no public policy against coverage.

106. KAN. STAT. § 40-3101 (1975) (providing for mandatory liability insurance).

107. *Id.* § 40-3107(b).

108. 375 F.2d 523 (10th Cir. 1966).

109. *Id.* at 527. *Accord* Price v. Hartford Accident & Indem. Co., 16 Ariz. App. 511, 494 P.2d 711, *rev'd on other grounds,* 108 Ariz. 485, 502 P.2d 522 (1972) (financial responsibility law held compensatory); Suarez v. Aguiar, 351 So. 2d 1086, 1088 (Fla. Dist. Ct. App. 1977) (uninsured motorist act does not extend to punitive damages); Teska v. Atlantic Nat'l Ins. Co., 59 Misc. 2d 615, 300 N.Y.S.2d 375 (Dist. Ct. 1969) (financial security law held compensatory); Laird v. Nationwide Ins. Co., 243 S.C. 388, 134 S.E.2d 206 (1964) (uninsured motorist statute held compensatory, case subsequently overruled by S.C. CODE § 46-750.31(4) (Supp. 1975); *see* note 100 *supra). Cf.* Hartford Accident & Indem. Co. v. Wolbarst, 95 N.H. 40, 57 A.2d 151 (1948) (financial responsibility act held compensatory, in New Hampshire punitive damages are compensatory).

110. 477 S.W.2d 341 (Tex. Ct. App. 1972).

111. *Id.* at 343 (citing Brin, *Punitive Damages and Liability Insurance,* 31 INS. COUNSEL J. 265 (1964)).

ance commission;[112] and last, that this approval was declarative of the public policy of Texas. From these findings, the court concluded that coverage could not be contrary to public policy.[113]

If the *Wallgren* court had construed the policy to *exclude* punitive damages, then on the above reasoning the public policy of Texas would have denied coverage. Thus, even assuming that the court was correct in allowing an administrative body to control public policy,[114] the court should have considered the intent with which the language was used.

The *Wallgren* court also held that punitive damages were covered because the policy in question was required under the Texas financial responsibility act. The court reasoned that since this act was meant to protect the public, refusal to enforce fully the insurance policy on public policy grounds would withdraw the protection intended by the legislature.[115] Again, this reasoning is too simplistic because the court failed to consider whether the financial responsibility law was enacted to assure recovery of punitive damages, or just to guarantee compensation to accident victims.[116]

Therefore, an exception to the *McNulty* rule can be clearly carved out only when, as in South Carolina, a statute expressly provides coverage for punitive damages. In the absence of such a statute, however, courts should not expand general compensatory statutes to punitive damages in the absence of legislative intent.

3. Vicarious Liability.—Under the theory of respondeat superior employers have been held vicariously liable for awards of punitive damages against their employees.[117] Several courts have

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112. *Id.* at 342 (citing United States Ins. Co. v. Boyer, 153 Tex. 415, 269 S.W.2d 340 (1954)).

113. *Id.*

114. *See* Anderson, *supra* note 24, at 621-22.

115. The court relied upon RESTATEMENT OF CONTRACTS § 601 (1932), which provides as follows:

> If refusal to enforce or to rescind an illegal bargain would produce a harmful effect on parties for whose protection the law making the bargain illegal exists, enforcement or rescission, whichever is appropriate, is allowed.

116. The same reasoning is evident in Greenwood Cemetery, Inc. v. Travelers Indem. Co., 238 Ga. 313, 232 S.E.2d 910 (1977):

> The Georgia Insurance Code, Code Ann. § 56-101 et seq., authorizes the issuance of liability insurance. Code Ann. § 56-408(1) provides, "Liability insurance, which is insurance against *legal liability* for . . . damage to property . . . ." (emphasis added). Punitive damages is [sic] a legal liability and accordingly insurance against such damages is expressly authorized.

Id. at __, 232 S.E.2d at 914. Again, the court ignored the legislative intent as well as the question of whether punitive damages are awarded for damage to property. Moreover, the statute involved here was only a definitional section which was read to "authorize" not mandate insurance of punitive damages. Mere authorization would not foreclose examination of the scope of the insurance contract itself.

117. *See* Comment, *Liability of Employers for Punitive Damages Resulting From Acts of Employees,* 54 CHI-KENT L. REV. 829 (1978). This rule has been criticized as serving no function when the employer is not culpable. *See, e.g.,* DEFENSE RESEARCH INSTITUTE, *supra* note 2, at 12-13. A broad exception to this rule exists in many states for governmental employers.

circumvented this rule, however, by allowing the employer to insure against such liability so long as he did not participate in or ratify the wrong.[118] Such a result does not violate public policy; the wrongdoer remains uninsured, and there is no significant reason to punish the innocent employer.[119]

Of course, as a prerequisite to excepting vicarious liability from the *McNulty* rule, the court must first broach the contractual issues raised in section III, above. Interestingly, despite the debate engendered over the scope of liability policies when the insured is primarily liable, no court has narrowly construed the insurance contract to exclude punitive damages when the insured is vicariously liable.[120]

4. Competing Considerations.—Some courts have found that despite the validity of the *McNulty* rule as a norm, certain fact situations justify deviation to satisfy competing considerations. Applying this approach, one court has permitted insurability of statutory treble damages,[121] while another has permitted police to insure against punitive damages arising from a false arrest.[122]

State and federal statutes may impose automatic multiplying of compensatory damages as a means to punish the defendant.[123] Under such statutes the factfinder has no opportunity to fit the punishment to the wealth of the defendant or the culpability of his conduct. In fact, at least some of these statutes allow damages to be trebled regardless of culpability.[124] Hence, absent insurability, a poor defendant whose conduct unfortunately caused severe injury

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See, e.g., State v. Sanchez, 119 Ariz. 64, 579 P.2d 568 (1978); N.J. STAT. ANN.§ 59:9-2 (West Supp. 1978).

118. Ohio Cas. Ins. Co. v. Welfare Fin. Co., 75 F.2d 58, 60 (8th Cir. 1934); Norfolk & W. Ry. Co. v. Hartford Accident & Indem. Co., 420 F. Supp. 92, 96 (N.D. Ind. 1976); Travelers Ins. Co. v. Wilson, 261 So. 2d 545, 548 (Fla. Dist. Ct. App. 1972); Scott v. Instant Parking Inc., 105 Ill. App. 2d 133, 245 N.E.2d 124 (1969); Esmond v. Liscio, 209 Pa. Super. Ct. 200, 214, 224 A.2d 793, 800 (1966). *But see* First Nat'l Bank of St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 231, 389 A.2d 259, 361 (1978) (liability based on a corporate decision is direct, not vicarious).

119. Such an award is frequently sought to be justified on the dubious theory that vicarious liability serves the public interest by inducing employers to use greater care in the selection and supervision of their employees. The absurdity of this makeweight argument is apparent to anyone who has ever been in the position of offering employment—there simply is no way to gauge whether a potential employee will become violent when irritated, just as there is no method of determining with certainty whether he will be a good worker.

Duffy, *Punitive Damages: A Doctrine Which Should be Abolished,* in DEFENSE RESEARCH INSTITUTE, *supra* note 2, at 12-13.

120. *See, e.g.,* Sterling Ins. Co. v. Hughes, 187 So. 2d 898 (Fla. Dist. Ct. App. 1966).

121. Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 267 N.W.2d 595 (1978).

122. Colson v. Lloyd's of London, 435 S.W.2d 42 (Mo. Ct. App. 1968).

123. *See, e.g.,* WIS. STAT. ANN. § 174.04 (West 1979) (treble damages for injuries inflicted by dogs when the owner has notice of prior injuries). *See also* 15 U.S.C. § 15 (1976) (treble damages for violations of the antitrust laws); this section was held punitive in Clark Oil Co. v. Phillips Petroleum Co., 148 F.2d 580 (8th Cir.), *cert. denied,* 326 U.S. 734 (1945).

124. Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 102, 267 N.W.2d 595, 600 (1978). *But see* CONN. GEN. STAT. ANN. § 14-295 (West Supp. 1979) (providing for doubling or trebling of damages if, in the discretion of the court, such doubling or trebling is just).

would suffer greatly, while a wealthy defendant whose conduct was extreme and outrageous might escape with light punishment.[125]

In *Cieslewicz v. Mutual Service Casualty Insurance Co.*,[126] these distinctions between common-law punitive damages and statutory multiple damages were held sufficient to overcome strict application of *McNulty*.[127] The court placed particular emphasis on the risk that under the statute in question treble damages could be awarded against a nonculpable defendant.[128] While the court admitted that some deterrence would be sacrificed by insurability, it recognized that public policy "is no magic touchstone."[129]

The *McNulty* court itself left open the possibility of an exception such as this by defining punitive damages as those awarded for "intentional or malicious wrongdoing" or other conduct of a "criminal character."[130] By implication, when the conduct does not involve any culpability beyond negligence, *McNulty* would not apply.[131]

A second fact situation justifying departure from strict application of *McNulty* involves claims against police officers. A municipality or individual police associations may carry liability insurance for personal injury claims arising from false arrest, detention, malicious prosecution, and assaults and batteries alleged to have been committed in making or attempting to make an arrest.[132] Such insurance does not contain a bodily injury clause and, therefore, may easily be read to include awards of punitive damages.[133] Moreover, such policies may insure against damages resulting from intentional acts without offending public policy if the police conduct is not in itself criminal, extreme, or outrageous. This is based on the need to pro-

125. *See* Cieslewicz v. Mut. Serv. Cas. Ins. Co., 84 Wis. 2d 91, 102, 267 N.W.2d 595, 600-01 (1978).

126. *Id.*

127. *Id.*

128. *Id.* at 103, 267 N.W.2d at 601. Under the statute in question the owner of a dog could be liable for treble damages for injuries inflicted by the dog.

> For the purpose of awarding treble damages under [this statute,] all that is necessary is that it be shown that the dog had previously injured someone . . . and that the owner had notice of the previous injury. Whether the dog is known to be violent and vicious, so that the owner's conduct in not restraining the dog is extreme recklessness, or whether the dog is normally gentle, but has had one prior incident, makes no difference for the purpose of the statute. Treble damages are awarded in either case.

Id. at 102, 267 N.W.2d at 601. This characteristic of the statute in *Cieslewicz* distinguishes the case from Tedesco v. Maryland Cas. Co., 127 Conn. 533, 18 A.2d 357 (1941), in which statutory treble damages that were awarded *in the court's discretion* were held uninsurable.

129. 84 Wis. 2d at 103, 267 N.W.2d at 601.

130. Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 442 (5th Cir. 1962).

131. This suggests that the *McNulty* principle should not be applied in malicious prosecution cases in which punitive awards are automatically permissible despite the absence of outrageous conduct. *See* notes 82-84 and accompanying text *supra.*

132. *See, e.g.*, City of Newark v. Hartford Accident & Indem. Co., 134 N.J. Super. 537, 543, 342 A.2d 513, 516 (1975).

133. Colson v. Lloyd's of London, 435 S.W.2d 42, 46-47 (Mo. Ct. App. 1968). *See also* Grant v. North River Ins. Co., 453 F. Supp. 1361, 1370 (N.D. Ind. 1978).

tect police in the performance of their duties.[134]

Logically, such insurance protection should also be extended to punitive damages, but the New Jersey Superior Court and an Indiana Federal District Court have ruled that neither the police nor the municipality may insure against a direct award of punitive damages.[135] A contrary result was reached in *Colson v. Lloyds of London*[136] in which the court held that the *McNulty* rule was inapplicable because,

> Here we are faced with the problem of whether it would be against public policy to permit an association of law enforcement officers to insure themselves against alleged wilful and intentional acts. In our opinion, it would not. It would be extremely rare, particularly in a suit for false imprisonment where the insured participates in the restraining or manhandling of the plaintiff, for there not to be an assertion that this was ground for the assessment of punitive damages. During the year we have seen violence stalk the streets of our cities. And it is common knowledge that the rate of crime throughout the country is on the increase. This has brought about great public demand for more and better trained law enforcement officers. What effect . . . would it have upon qualified persons giving heed to that demand if they were told by the courts that they could not enter into a contract which would afford them protection . . . from claims for punitive damages? That it would tend to discourage them from entering into that public service goes without saying.[137]

If the *Colson* court correctly assessed the effect of punitive damage awards on police, then to deny insurance would cause a harm to the public—the very group that *public* policy is meant to protect.[138]

V. Conclusion

From the preceding discussion a coherent rule can be designed to govern the insurability of punitive damages. First, based upon possible ambiguities and the expectations of the insured, standard liability policies should be read to allow coverage of punitive damages unless there is an express exclusion. Second, in most instances

134. City of Newark v. Hartford Accident & Indem. Co., 134 N.J. Super. 537, 547, 342 A.2d 513, 518 (1975).

135. Grant v. North River Ins. Co., 453 F. Supp. 1361 (N.D. Ind. 1978); City of Newark v. Hartford Accident & Indem. Co., 134 N.J. Super. 537, 342 A.2d 513 (1975); Hartford Accident & Indem. Co. v. Village of Hempstead, 48 N.Y.2d 218 (1979). At least in the *Grant* case other factors may have protected the police from punitive damages. Since the city of Fort Wayne was also named in the action, under IND. CODE ANN. § 34-4-16.5-5(a) (Burns Supp. 1978), the action against the police was arguably barred. Furthermore, the city of Fort Wayne had assumed a contractual duty to indemnify city employees for damages awarded for acts done in good faith. 453 F. Supp. at 1371.

In contrast the New York Court of Appeals expressly stated in *Village of Hempstead* that public policy does not permit insurance coverage of punitive damage awards against municipal police officers in a 42 U.S.C. § 1983 civil rights action.

136. 435 S.W.2d 42 (Mo. Ct. App. 1968).

137. *Id.* at 47.

138. *See* note 115 *supra.*

the *McNulty* public policy rule should void such coverage. This is important not only to avoid wasteful awards,[139] but also to insure that a wrongdoer does not escape punishment. Last, in certain limited situations the *McNulty* rule should be set aside in favor of permitting coverage. These exceptions are present when under state law punitive damages are substantially compensatory, when a state statute provides for coverage, when punitive damages can be awarded without some degree of culpability, and finally, when inability to shift the risk of punitive damages could harm the public.

139. The prospects of wasteful awards was one of three practical arguments against insurability of punitives raised in Northwestern Nat'l Cas. Co. v. McNulty, 307 F.2d 432, 441 (5th Cir. 1962). The other two were the possibility of conflicts of interest between the insurer and the insured and the possibility of conflict between the inadmissibility of evidence of insurance and the admissibility of evidence of wealth to set punitive damages.

The *McNulty* decision did not state what conflicts of interest would be created by insurability, but logically those conflicts should be no greater than when damages are covered by insurance. In fact, the conflicts seem greater when insurability is denied to punitive damages. For example, if the insurer negotiates a $5,000 settlement how can it be decided what part is compensatory and what part is punitive? Further, when the insurer disclaims liability for punitive damages he is under a duty to notify the insured and to suggest procedures that might limit the impact of the punitive damages on the defendant. *See generally* Ging v. American Liberty Ins. Co., 423 F.2d 115, 120-21 (5th Cir. 1970); Gonsoulin, *Is an Award of Punitive Damages Covered under an Automobile or Comprehensive Liability Policy,?* 22 Sw. L.J. 433, 443-44 (1968).

Nor has the conflict between the nonadmissibility of insurance policies and the admissibility of evidence of wealth created difficulties as feared in *McNulty.* Presumably, if punitive damages are insurable then the insurance policy becomes admissible evidence of the defendant's wealth. This could affect the jury's findings on liability and cause inflation of punitive damages by the amount of insurance coverage. Since *McNulty* this problem has only been raised twice. *See* Odoms v. Travelers Ins. Co., 339 So. 2d 196 (Fla. 1976); Svejcara v. Whitman, 82 N.M. 739, __, 487 P.2d 167, 169-70 (1971). Both courts found admission of the defendant's insurance policies harmless error on the facts, but the *Odoms* court added that it was error for the lower court to allow consideration of the insurance limits in setting punitive damages.